Practice Questions for Exam 1 – The Classical Model

1. What is the relationship between real and nominal GDP?
   a. real GDP = nominal GDP – Price level
   b. nominal GDP = Real GDP/Price level
   c. real GDP = nominal GDP/Price level
   d. real GDP = nominal GDP + Price level.

2. One factor which did not influence the levels of real output and employment in the classical system was the
   a. stock of capital.
   b. level of technology.
   c. the price level.
   d. size of the labor force.

3. The classical economists attacked the mercantilist propositions that
   a. state action was necessary to direct the capitalist system.
   b. money had no intrinsic value.
   c. output was completely supply-determined.
   d. the wealth of a nation was closely linked to the country’s stock of precious metals.
   e. Both a and d

4. The supply-determined nature of output and employment is a crucial feature of
   a. the Keynesian theory.
   b. the classical system.
   c. monetarism.
   d. the rational expectations model.

5. Which of the following is not consistent with perfect competition?
   a. Workers bargain individually for their wages.
   b. Labor demand is determined by real wages and the marginal product of labor.
   c. The marginal product of labor is diminishing.
   d. Workers have no influence on their wages but accept them as given.
   e. None of the above.

6. The supply of labor in the classical system is a function of the
   a. marginal product of labor.
   b. real wage.
   c. the public’s preference for leisure.
   d. money wage.
   e. b and c

7. For a given level of the money wage, an increase in the price level will cause the
   a. supply of labor to rise.
   b. quantity of labor demanded to rise.
   c. price of leisure to rise.
   d. demand for labor to rise.
   e. both b and d.
8. Which of the following is not consistent with perfect competition?
   a. all firms face the same costs.
   b. firms cannot determine the price of the goods they sell.
   c. the marginal product of labor is diminishing.
   d. firms negotiate the same wages for different workers.

9. In the classical model, an increase in tax on firms that hired labor would
   a. decrease labor demand and the real wage and increase output.
   b. decrease labor supply, increase the real wage, and decrease output.
   c. decrease labor demand, decrease the real wage, and decrease output.
   d. reduce real wages and increase output.

10. With respect to the classical labor market analysis, it is not assumed that
    a. firms have complete information with respect to relevant prices.
    b. workers negotiate for unique wages individually.
    c. money wages adjust with a short lag.
    d. All of the above
    e. None of the above

11. If a natural disaster destroys some of the capital stock, then the classical model predicts
    a. labor demand, real wages, and output will fall.
    b. labor demand and real wages will rise, output will fall.
    c. the labor market remains unchanged but output falls.
    d. None of the above

12. Which of the following factors will not determine output and employment in the classical model?
    a. Taxes that affect the incentive to work or hire labor
    b. The level of government spending
    c. The quantity of capital
    d. Preferences for leisure
    e. None of the above

13. Which of the following will increase the marginal product of labor in the labor market?
    a. An increase in the price level and the money wage.
    b. An increase in the real wage.
    c. A decrease in the capital stock.
    d. An increase in the supply of labor.

14. In the classical model,
    a. firms are assumed to be perfect competitors who choose their output level so as to maximize profits.
    b. the perfectly competitive firm will increase output until the marginal cost of producing one unit of output equals the marginal revenue received from the sale of that particular unit of output.
    c. marginal revenue is equal to product price for the perfectly competitive firm.
    d. All of the above
15. If there is an increase in the price level in the classical model,
   a. the equilibrium level of output will remain unchanged.
   b. real wages remain constant.
   c. money wages will rise proportionally.
   d. all of the above.

16. The equation of exchange is a(n)
   a. identity relating the volume of transactions at current prices to the stock of 
      money times the turnover rate of each dollar.
   b. "truisms" and by itself does not explain the variables it contains.
   c. identity relating the volume of transactions at base year prices to the stock of 
      money times the turnover rate of each dollar.
   d. Both a and b
   e. Both b and c

17. Which of the following is (are) correct? In the classical system, the suppliers of 
   bonds are the
   a. government which always sold bonds to finance a new project.
   b. firms which financed investment expenditures by selling bonds.
   c. government which might sell bonds to finance spending in excess of tax 
      revenues.
   d. Both b and c.

18. If the money supply increases 10-percent, velocity decreases 5-percent, and the 
   price level increases 6-percent, then the change in real GDP is
   a. 1%.
   b. 4%.
   c. -1%.
   d. 5%.

19. The difference between savings and investment is that
   a. investment is purchasing stock, while savings is putting money in a bank.
   b. investment is purchasing capital, savings is postponing consumption.
   c. investment is purchasing assets, while consumption is purchasing goods.
   d. investment increases output, while savings decreases output.
20. According to the classical model shown in Figure 4.1, an autonomous decline in investment shifts the investment schedule to the left. Furthermore, the equilibrium interest rate declines. Distance B describes an interest rate induced
   a. decline in saving, which is an equal increase in consumption.
   b. increase in investment.
   c. decrease in investment.
   d. decline in saving, which exceeds the increase in consumption.

21. According to the classical model shown above, an autonomous decline in investment shifts the investment schedule to the left. Furthermore, the equilibrium interest rate declines. Distance A describes an interest rate induced
   a. decline in saving, which is an equal increase in consumption.
   b. increase in investment.
   c. decrease in investment.
   d. decline in saving, which exceeds the increase in consumption.

22. According to the classical system, saving is a function of
   a. income.
   b. the real interest rate.
   c. the real wage.
   d. the profitability of firms.
   e. all of the above.

23. According to the quantity theory, inflation is ultimately controlled by
   a. private firms who set prices.
   b. the monetary authorities who control the money supply.
   c. those who control output.
   d. the price of oil.
24. Classical economists
   a. argued that the money supply determined aggregate demand.
   b. regarded monetary policy as unimportant since the quantity of money does not determine the price level.
   c. believed that the quantity of money influences interest rates and real wages.
   d. believed that prices would increase more than proportionate to an increase in the money supply.

25. Supply-side economists
   a. focus almost exclusively on the supply-side effects of changes in the money supply.
   b. did not devote much attention to the supply-side effects of changes in income tax rates since the marginal income tax rate is very low and pertained only to the relatively wealthy.
   c. argued that cuts in marginal tax rates had very favorable supply-side effects.
   d. argue that government spending is at least as important as tax rates.

26. In the classical model, if money growth and velocity are constant, then:
   a. the price level will rise at the rate of output growth.
   b. the price level will be constant.
   c. the price level will fall at the rate of output growth.
   d. none of the above.